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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Special Access Rates for Price Cap Local Exchange Carriers	)	WC Docket No. 05-25
	)	
AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services	)	RM-10593

REPLY COMMENTS OF PAETEC COMMUNICATIONS, INC. AND US LEC CORP.

PAETEC Communications, Inc. and US LEC Corp.[1] (collectively "PAETEC") hereby reply to the comments submitted to refresh the record in this ongoing Federal Communications Commission ("Commission") proceeding[2] focused on correcting the national market failure in the wholesale special access marketplace.

I. Competitors and Enterprise Customers Have Thoroughly Documented the ILECs' Continued Monopolization of Special Access Services

It might be understandable if the Commission were to conclude after reading the comments filed on August 8 that parties were describing two different markets. The first,

[1] Including its operating subsidiaries identified in footnote 1 of the Comments of PAETEC Communications, Inc., WC Docket No. 05-25 (filed August 8, 2007) ("*PAETEC Comments*"). All references in this filing to "________ Comments" are to the comments filed by that party in WC Docket No. 05-25 on August 8, 2007.

[2] *Notice to Refresh Record In The Special Access Notice Of Proposed Rulemaking*, WC Docket No. 05-25, RM-10593 (released July 9, 2007) ("*Notice*").

described unanimously by competitive service providers and enterprise customers alike, is a dark and foreboding scenario of extended and extensive market failure. In this market:

- Facilities-based competitive alternatives for special access are not widely available and ILEC (mostly BOC) special access services account for up to 98 percent of the special access circuits used by competitors and enterprise customers.[3]
- The prices for BOC special access services have remained high and in many cases increased in the eight years since the 1999 *Pricing Flexibility Order*, causing customers millions of dollars a day in excess costs and harming growth in other sectors of the U.S. economy.[4]
- The effect of the 2005 and 2006 BOC/IXC and BOC/BOC mergers has been to further limit the availability of competitive special access facilities and providers and to increase competitors' and customers' reliance on ILEC facilities.[5]
- Contract provisions that lock in customers and foreclose much of the market to competing special access providers for years are anti-competitive barriers to entry and prevent the development of

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[3] *See, e.g., Ad Hoc Telecommunications Users Group ("Ad Hoc") Comments* at 8-10 and App. 2; *American Petroleum Institute ("API") Comments* at 6-7; *ATX et al Comments* at 23-24; *BT Americas Comments* at 4-11; and *PAETEC Comments* at 8-12.

[4] *See, e.g., Ad Hoc Comments* at 6, 10-14, and Apps. 1 & 2; *ATX Comments* at 9-16; *COMPTEL Comments* at 7-8; *COVAD et al Comments* at 11-35; *Global Crossing Comments* at 5-8; *Sprint-Nextel Comments* at 8-21; and *Time Warner Telecom- One Communications ("TWT/One") Comments* at 31-33.

[5] *See, e.g., Ad Hoc Comments* at 15-21; *T-Mobile Comments* at 6-8; *TWT/One Comments* at 11-14.

facilities-based competition, but customers have no choice but to agree to such provisions because of the ILECs' market power.[6]

- Competitors' and customers' increased reliance on ILEC facilities has occurred in spite of their vigorous and concentrated efforts to find alternative special access providers.[7]

On the other hand, the BOCs and large ILECs describe a market straight out of Lake Wobegon, where, to paraphrase Garrison Keillor, "all the competitors are strong, all the new technologies are attractive alternatives, and all the ILECs' returns on special access services are merely average." In this alternative reality,

- Special access prices are "reasonable,"[8] "are falling,"[9] or are "approximating cost."[10]
- Facilities-based competition in the special access market is "extensive" (at least "wherever appreciable demand for high capacity circuits exists"),[11] "robust,"[12] and "robustly competitive."[13]
- Contract provisions that lock in customers and foreclose much of the market to competing special access providers for years are evidence of responsiveness to customer demand and demonstrate the introduction of new service offerings.[14]

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[6] *See, e.g., ATX Comments* at 50-51; *BT Americas Comments* at 10-11; *COMPTEL Comments* at 9-16; *Global Crossing Comments* at 8-10; *TWT/One Comments* at 36-40.

[7] *See, e.g., Ad Hoc Comments* at 6-9; *PAETEC Comments* at 4-6; *Sprint Nextel Comments* at iii and 29-33; *T-Mobile Comments* at 6-8; *TWT/One Comments* at 11-14.

[8] *See Embarq Comments* at 8-10 and *USTA Comments* at 13-14.,

[9] *Qwest Comments* at 45-47.

[10] *Embarq Comments* at Summary.

[11] *Verizon Comments* at 13-20.

[12] *USTA Comments* at 14-18.

[13] *Qwest Comments* at 19.

[14] *Verizon Comments* at 7-10.

- The markets for wireless services and retail services that use special access services are highly competitive, so any special access market failures are not harming competitors or consumers in those or other markets.[15]

ILECs consistently argue that as a result of these factors, not only is there no need to re-regulate the special access market, but in fact further deregulation is justified by the development of competition.[16]

We trust that the Commission can easily separate fact from fiction and determine which of these two worlds corresponds to reality.

II. The Date Submitted by ILECs, Competitors and Customers Confirm the Continued Market Failure in Special Access Services

A. Even the ILECs' data confirm that special access prices have failed to decline to an extent consistent with other, truly competitive communications markets

There is substantial disagreement between the ILEC and non-ILEC commenters about the exact direction that special access prices have trended in the last six years, especially in markets where Phase I or II pricing flexibility has been implemented. PAETEC believes that the evidence is overwhelming that the prices for special access services, at least in Phase II areas, have been flat or rising, and in any event are on average higher than in Phase I and price cap areas.[17] Nonetheless, even assuming that

[15] *See, e.g., Verizon Commments* at 29-37 and *AT&T Comments* at 46-49.

[16] *USTA Comments* at 14-18; *AT&T Comments* at 24-43; *Embarq Comments* at 13-16; *Qwest Comments* at 53-62; *Verizon Comments* at 45-50.

[17] *See* filings cited in footnote 3*, supra.* PAETEC is willing to concede, for purposes of argument, that in a handful of cases ILECs might plausibly have used price flexibility to raise prices in limited areas where price caps had kept the prices below cost. This possibility cannot, however, explain the widespread nature of such Phase II price increases. Moreover, if competition had developed in the affected areas, as the Commission's methodology predicted, then the prices would by definition trend towards the lowest-cost producer's costs (not the ILEC's cost) and the ILEC would not have been able to maintain a price increase over the long term,

the ILECs' self-serving data are accurate, prices for their special access services have at best been flat or showed slight declines.[18]

Whatever the exact numbers, even the ILECs' data confirm that special access prices have not declined substantially since the institution of price flexibility. This confirms the lack of competition and the broad scope of the market failure. There is no question that prices in truly competitive telecommunications markets declined much more in the same period. For example, as AT&T noted, average prices in the domestic wireless market – a market that is widely accepted as a model for price competition - declined over 68%, from 22 cents per minute to 7 cents per minute, during the 1999-2005 period.[19]

Prices –including ILEC prices - for telecommunications products and services in markets where competition truly exists showed similar rates of decline. For example, Time Warner Telecom and One Communications pointed out in their comments that the ILEC prices on long haul transmission routes have fallen 90% in roughly the same period.[20] During the 2002-2006 period, the monthly price of an OC48 circuit between New York and Los Angeles declined approximately 55%, from $135,000 to less than $60,000, and the monthly charge for an STM1 between LA and Tokyo fell more than 75%, from over $90,000 to below $20,000.[21] Thus, it is clear that if the special access market were actually functioning in a competitive manner, any price declines would have been far more widespread and substantial even than those identified by the ILECs.

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given the dramatic drop in equipment prices since 1999. That ILECs have been able to do so over the long term is simply another indication of market failure.

18 *See* filings cited in footnotes *7-9, supra.*

19 *AT&T Comments* at 47.

20 *TWT Comments* at 33-34.

21 Telegeography Research, *Global Traffic, Bandwidth, and Pricing Trends and Wholesale Market Outlook, January 14, 2007* at 21 and 22 (viewed August 13, 2007 at http://ptc07.org/program/presentation/ST_BeckertSchoonover.pdf).

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B. Competitors' and enterprise customers' data confirm the GAO's conclusion that onerous ILEC contract conditions constitute daunting barriers to market entry

PAETEC and numerous other parties demonstrated in their initial comments that the GAO was absolutely correct in noting that long-term arrangements required by ILECs (in most cases, BOCs) foreclose much of the special access market and thus serve as formidable barriers to competition. Numerous commenters have documented the wide variety of contract provisions that are being used by ILECs to lock up the special access market and make it economically inefficient – and thus irrational - for competitors to enter that market.[22]

Not surprisingly, ILECs generally did not address this key finding by the GAO. They argue that "the critical issue is . . . what level of special access demand is contestable,"[23] but fail to address the GAO finding or the fact that numerous contract provisions imposed by ILECs create entry barriers that effectively make most of the special access market non-contestable.[24]

Verizon, one ILEC that did obliquely speak to the issue, colorfully argued that its plans containing these types of provisions of adhesion, such as the new National Discount Plan, are part of "a broad range of innovative options, [introduced] in response to customer demand."[25] This is nonsense. There is customer demand for lower prices and greater flexibility, but there is certainly no demand from customers for economically restrictive, anticompetitive provisions that bear no reasonable relationship to any efficiencies yielded by volume and term commitments. The onerous contractual

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22 *See* filings cited in footnote *5, supra.*

23 *See, e.g., AT&T Comments* at 53-54.

24 A market is not contestable if it has substantial barriers to entry (and exit). *See* William J. Baumol, John C. Panzar, & Robert D. Willig, *Contestable Markets and the Theory of Industry Structure* (1982).

25 *Verizon Comments* at 7.

provisions imposed by AT&T, Verizon, Qwest, and other large ILECs - such as requirements to move special access purchases from competitors' networks or to increase spend annually with the incumbent (either in absolute terms or as a percentage of total spend) - are designed and serve only to foreclose large parts of the market and impede the development of competitive facilities-based providers.[26] No intelligent customer would submit to these types of business-limiting restrictions if it had any choice. The fact is, enterprise customers and competitors submit only because they have no choice but to use ILEC special access services.

III. The Commission Must Adopt a New Regulatory Paradigm to Assure Reasonable Rates and Conditions for Special Access Services

The data on pricing and facilities availability placed in the record in response to the *Notice* compel a finding of market failure in the special access market. As it indicated in its Comments, PAETEC would support Commission adoption of any of the variations on a price cap regime that have been proposed by it and other commenters. The Commission may consider implementing a variety of forms of relief in order to rectify the ongoing market failure and encourage the development of true competition in special access services. In doing so, it should take into account the widespread view of ILEC and non-ILEC commenters alike about the time and resources that will inevitably be required to re-establish price regulation, and the difficulty of establishing price regulation that will survive judicial review. At best, a decision to re-establish price regulation would not provide relief for a year or more. At worst, it could be several years.

26 *See GAO Report* at 30-31 and the filings cited in footnote 6, *supra*.

These facts counsel strongly for an interim solution that is fast and efficient, and will not require intensive use of Commission resources. The commercial arbitration remedy proposed by PAETEC, Global Crossing, and BT Americas has precisely those attributes.[27] The condition minimizes the day-to-day involvement of the Commission in regulating the market, thus allowing it to concentrate its resources on designing creative permanent means of resolving the special access market failure. Because the procedure set out in Exhibit A to our Comments would require parties involved in arbitrations to make the resulting agreements available to Commission staff, pursuant to a suitable protective order, the Commission would have access to information about the pricing and availability of both ILEC and competitive providers' special access services and facilities.

Moreover, the remedy could wither away if not needed. If the ILECs are right and the affected markets are competitive, special access customers will not need to use the arbitration remedy because there will be no benefit to doing so. The first few arbitrations will demonstrate that the outcome of the process is similar, if not identical, to the rates, terms and conditions already offered by the ILEC. At that point, ILECs would have a strong argument that no permanent relief is necessary. If, on the other hand, the affected markets are not competitive, then the arbitration remedy will be a crucial mechanism for bringing the discipline of competition to special access markets while at the same time developing an evidentiary record of widespread market failure. Indeed, the

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[27] *See, e.g., PAETEC Comments* at 16-23 and Exhibit 1; BT Americas Comments at 23-24; and *Global Crossing Comments* at 11-16.

persistent use of arbitration by competitors would confirm the data submitted in this proceeding showing that competition has not yet emerged in the special access market.

Failure to implement interim relief could foreclose any hope of achieving even marginally competitive special access markets in this decade.

IV. Whichever Interim Remedy is Selected Must be Accompanied by A Fresh Look Option

There was near unanimity among non-ILEC commenters about the need for a fresh look provision in connection with the introduction of any new interim or permanent regulatory relief. The public interest in fresh look is compelling. Existing long-term arrangements with ILECs are the product of hugely disproportionate bargaining power and run for anywhere from a few months to five years. If a new regulatory scheme - whether interim or permanent - is introduced without fresh look, it will take up to five years for all special access customers to even begin to benefit from the Commission's action. That would push any realistic possibility of a generally competitive and contestable special access market well into the next decade. That outcome would not bode well for the American economy and the telecommunications industry.

CONCLUSION

For the foregoing reasons, PAETEC respectfully urges the Commission to adopt the interim remedy outlined above and in our August 8 Comments pending a final order in this proceeding.

Respectfully submitted,

/s/__________________________
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Date: August 15, 2007

CERTIFICATE OF SERVICE

The undersigned hereby certifies that on this 15th day of August, 2007, a true and correct copy of the foregoing Reply Comments of PAETEC Communications, Inc., was served via electronic mail on the following:

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